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UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

# COMMON EUROPEAN ECONOMIC SPACE

Study prepared by a consultant*

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## ABBREVIATIONS

| | |
|---|---|
| EEC | European Economic Community |
| EFTA | European Free Trade Association |
| CMEA | Council of the Mutual Economic Assistance |
| CEES | Common European Economic Space |
| N+N | Neutral and non-aligned countries of Europe |
| GATT | General Agreement on Tariffs and Trade |
| IMF | International Monetary Fund |
| ECE | United Nations Economic Commission for Europe |
| CSCE | Conference on Security and Co-operation in Europe |
| Eastern Europe: | Bulgaria, Czechoslovakia, Hungary, Poland, Romania and the former German Democratic Republic |

## FOREWORD

In its resolution 380 (XXXVI), the Trade and Development Board agrees on the need to ensure that bilateral arrangements and regional economic integration, especially those which have a major impact on global trade, in particular on the trade and development of developing countries, impart dynamism to global trade and enhance trade and development possibilities for the developing countries and calls on member States involved to continue to promote necessary policies and adopt appropriate measures in this regard".

This concept clearly applies to the Common European Economic Space (CEES) which is now on the drawing board of politicians and economists, with a view to shaping the future of Europe. Having continental and global dimensions, CEES would have implications for the world economy and trade, including that of developing countries. As stated in Trade and Development Report, 1989, "several developments of the last two to three years have caused a number of observers to express the fear that the multilateral trading system may be fragmented into three large trading blocs" 1/ with negative implications for development. There are, however, authoritative contrary opinions on the subject. Much depends, therefore, on the practical measures and policies that would be adopted in the CEES setting.

This study has been prepared with a view to assessing the major aspects of the CEES setting and to discussing its effects on world trade, especially the trade and development of developing countries, under various implementation scenarios. The emphasis is on the impact of the recent political and economic changes in the USSR and in countries in Eastern Europe.

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## INTRODUCTION

1. After many decades of political, economic and institutional bifurcation, Europe is seeking to unite in a Common European Economic Space (CEES). Originally a slow and largely rhetorical process in the wake of the Helsinki Conference, the all-European movement has become increasingly dynamic in both parts of Europe. Propelling this movement are the single internal market in the EEC region in the West and perestroika aimed at installing a market economy and political pluralism in the East - with the result that all parts of Europe are becoming more adaptable, confident in each other and, in a word, continentally minded. Moreover, the idea is gaining ground that both Europes will be able to overcome their recent and future problems only by cooperating together.

2. These developments are embodied in many convergent political statements and documents, including that of the Conference on Security and Co-operation in Europe (CSCE), as well as in understandings elaborated in the CSCE summit held in Paris in November 1990. On the European agenda are the de facto economic merger of EEC and EFTA, an association for trade relations between EEC and Eastern Europe, and the steps to be taken towards a single legal, environmental, transport and - eventually - technological European space. Consequently, the process of economic cooperation is now much deeper and faster in Europe than in any other part of the world.

3. There are competing doctrines on how to proceed with European re-amalgamation. The Commission of the European Communities sees it as a three-step process, gravitating around EEC, as follows: establishment of the single EEC market in 1992; subsequent absorption of EFTA, Eastern Europe and N+N countries; and, finally, framing into CEES the USSR. Some socialist quarters, particularly in the European parliament, believe that "Western Europe can help Eastern Europe to modernize its economy, but cannot assimilate it" 2/ - the two Europes remaining rather in mutual co-existence. The Soviet doctrine, however, does envisage this process as a gradual rapprochement of all four European economic groupings (EEC, EFTA, N+N, CMEA) into a "common European house" by strengthening cooperation between them. N+N place emphasis on security issues and see the Mediterranean basin as a part of CEES. However, all these doctrines are fraught with uncertainty about the impact on developing countries. In fact, the Trade and Development Report, 1990 states that "political and economic reforms and progressive integration and cooperation in Europe have created a new dynamics that may lead eventually to the formation of a 'Common European House'. The new dynamics are found to have implications for the export opportunities of developing countries. On the one hand, European economic growth will undoubtedly accelerate, and so may the demand for developing countries exports. On the other hand, given the diversity of economic conditions and development level in Europe, the pursuit of greater economic integration will give rise to the temptation to resort to protectionist policy towards third countries. which could result in significant trade diversion". 3/

4. There are valid reasons for the reconsolidation of Europe. These include historical heritage, economic interdependence, the link between business cooperation and better security, and a stronger ability to meet external technological and competitive challenges which a bifurcated Europe might not

be able to cope with effectively. To this end, CEES would strengthen its global position, including vis-à-vis the United States and Japan. With the establishment of the CEES, the continent would be twice as strong economically as EEC - with a population of around 800 million, GNP almost $US 11,000 billion, R & D outlays of $140 billion, 125 million d.w.t. merchant fleet, etc. One should not underestimate in this regard the input from Eastern Europe (see annex 1), which is bigger than that of EFTA or N+N.

Table 1

Relative economic strength of the major world economic spaces, 1988

As a per cent of World

| | GNP | Export | R & D | Population |
|---|---|---|---|---|
| Western Europe | 25 | 32 | 25 | 8 |
| Eastern Europe | 4 | 3 | 4 | 2 |
| USSR | 14 | 4 | 16 | 6 |
| The United States | 20 | 13 | 38 | 5 |
| Japan | 11 | 8 | 17 | 2 |

Source: Soviet State Foreign Economic Commission Statistical Service. See also annex 1.

5. In qualitative terms, intra-European rapprochement is made easier by the recent profound economic and political changes in the continent. These include "EC-1992" and the involvement of EFTA and N+N countries in more trade with EEC than among themselves. There are at least some values and concepts held both in the West and in the East that will have a bearing on the shape of CEES. These include, according to the CSCE documents formulated in Vienna and Bonn, confidence in peace and stability in Europe, democratic values in internal policies, market economy as the common business mechanism, equal status for all types of properties, economic openness and the free flow of mutual trade, commercial autonomy of enterprises, freedom for all types of commercial transactions, etc. All this would remove to a large extent the previous rivalry between the social systems and bridge the gap between the business cultures of East and West. Although they are still not always enacted in law, the profound changes in the USSR and other countries in East Europe rule out the notion of centrally-planned economies and State trading. The reform of CMEA has also transformed it into an OECD-like consultative body which places no constraints on connections with the European and world economy.

6. It is particularly important to stress that most architects of CEES see it not as an enlarged "Fortress Europe" but as part and parcel of the world economy, accessible to goods, services and capital from outside. This is explicitly mentioned in the CSCE documents, in particular those of the Vienna Conference. The participating States "express their readiness to intensify the dialogue in the competent fora with a view to facilitating appropriate solutions for key interrelated economic issues, such as money, finance, debt and trade, and creating an international economic environment conducive to development". 4/ Equally, in the document of the Bonn Conference, the participants committed themselves "to facilitate the strengthening of a more open world trading system". 5/

7. There are, however, a few elements which ought to be taken into consideration before making any assessment of the implications of CEES for the rest of the world, and especially for developing countries. They are as follows:

(a) Despite a remarkable acceleration of the all-European process for the past two years, CEES is not an immediate prospect. Even the European Community is not sure whether it can cope with the schedule for "EC-1992"; and any enlargements of EEC or an economic merger EEC-EFTA may be expected only after the formation of a single European market. In the West the talk is confined to "association treaties" with East European countries till the end of the century; as for the USSR, because of its vastness, bicontinental geography and multi-State structure, it may join CEES as an autonomous area only. Therefore, the consequences for developing countries, whatever they may be, will become apparent over a rather long period of time.

(b) Fashionable self-deprecation notwithstanding, neither Eastern Europe nor the USSR are developing countries by international standards (see annex 1) and consequently they cannot play, within EEC, the role of poor regions directly competing with the countries of the South. Nevertheless the level of development of the two parts of Europe is unequal, as are the potentials for growth. Both parts are wrestling with their specific problems: the East is hit by the economic crisis, just as the West may be in the years to come. Therefore, the scope for their cooperation with developing countries will inevitably be changing, and such cooperation will remain specific to various parts of CEES, sectors, types of transactions, etc.

(c) During the time taken to establish CEES, the developing countries will themselves undergo profound changes and structural adjustments, the nature of which will differ from country to country and from one regional group to another.

In short, the effects of CEES for developing countries may be complex and may change with the passage of time. Specific effects are analysed in the following chapters.

## Chapter I

## THE OVERALL IMPACT ON DEVELOPING COUNTRIES

8. So far the developments in Europe and its various groupings have had a generally trade-creative effect on the outside world. In the present interdependent world economy, all these groupings have been gradually opening up to world markets. Taking 1980 as the base year, the trade turnover index for 1988 was 146 for EEC, 152 for EFTA, and 146 for CMEA, as against 142 for the world total. Moreover, this was not merely the result of the intra-European trade: all the aforementioned groupings have large-scale economic relations with developing countries.

Table 2

Network of European and developing countries trade

Annual average value of exports
(in billions of dollars)

| Origin - Destination | Ratio | | | |
|---|---|---|---|---|
| | 1959/71 | 1972/80 | 1987/88 | 1987/88 to 1969/71 |
| EEC - Developing Countries | 16 | 99 | 129 | 8.06 |
| EFTA - Developing Countries | 2 | 13 | 17 | 8.50 |
| CMEA - Developing Countries | 4 | 20 | 37 | 9.25 |
| Developing Countries - EEC | 19 | 71 | 117 | 6.16 |
| Developing Countries - EFTA | 2 | 10 | 11 | 5.50 |
| Developing Countries - CMEA | 3 | 13 | 20 | 6.66 |
| EEC - EFTA | 14 | 64 | 109 | 7.78 |
| EEC - CMEA | 4 | 20 | 22 | 5.50 |
| EFTA - EEC | 10 | 51 | 94 | 9.40 |
| EFTA - CMEA | 1 | 7 | 9 | 9.00 |
| CMEA - EEC | 4 | 22 | 33 | 8.25 |
| CMEA - EFTA | 1 | 8 | 11 | 11.00 |
| EEC - EEC | 56 | 302 | 597 | 10.66 |
| EFTA - EFTA | 4 | 15 | 24 | 6.00 |
| CMEA - CMEA | 18 | 71 | 122 | 6.77 |
| Developing Countries - Developing Countries | 11 | 104 | 143 | 13.00 |

Source: UNCTAD Handbook of International Trade and Development Statistics 1989, N.Y., 1990, p. 60, 61.

9. Therefore - with some exceptions for EFTA - trade between developing countries and the major trading subregions in Europe has so far been increasing faster than trade among the subregions, or sometimes even trade within these regions. The partners are now important to each other, and even in the case of CMEA, which has a marginal role in world trade, the developing countries accounted for about 10 per cent of its total trade turnover in 1988. The explanation is that the developing countries are becoming increasingly important in the world economy. With a total population of around 2.6 billion, a GNP of $US 2,400 billion, and exports and imports of about $US 580 billion the developing countries are comparable or even superior to many other blocs in the developed world, the CMEA included (see annex 2). Their importance cannot be ignored.

10. These considerations will remain valid for a new Europe too. However, there are some aspects of CEES interaction with the developing world which are likely to influence any forecasts and extrapolations. These are, inter alia:

- trade between developing countries and European countries has been subject to cycles and slowdowns (Western Europe in 1984-1986 and Eastern Europe in 1988-1989); the approach to this trade in individual European countries has varied widely from country to country;

- almost permanent export-import disequilibrium and terms of trade in favour of Europe;

- a rather large concentration of intraregional trade in Europe (in 1988, 60 per cent for EEC and 53 per cent for the CMEA), particularly because of the relevant intergovernmental arrangements;

- preferential bilateral or multilateral arrangements with selected developing countries, affecting the general trade flows;

- the geographical proximity of European countries.

11. Moreover, one can already discern some new trends that are equally influential on the effects under discussion. These are, inter alia:

- Europe is moving towards a homogeneous economic environment, already apparent in such areas as standardization, infrastructure, statistics, business norms and legislation;

- as CEES becomes a reality, narrower production and export specialization and less import substitution may be expected in all European countries, especially the smaller ones; this will lead them to a further structural dependence on both inside and outside the continent;

- the growing role of non-governmental agents in formulating national, regional and European economic policy and regulations;

- all-European "sheltering" policies may emerge in some specific areas such as agriculture, energy, communication, transport and technology. Such policies may place outsiders in an inferior trade position;

- the need for structural adjustments may lead to the danger that CEES countries, sectors and industries in a weaker position will argue for protection against external competition, particularly in the form of new non-tariff barriers.

12. All in all, in the long term one may expect CEES to have a favourable effect on the developing countries, although the impact is likely to be negative in the short run. In dealing with CEES, developing countries will be expected to rely more and more on comparative market advantages rather than on preferential arrangements, which implies more opportunities for NICS than for the LDCs. Likely forecasts for particular sectors are outlined in the following paragraphs.

13. Energy. With the depletion of its own deposits, Europe will be increasingly dependent upon outside supply. This is particularly true for Eastern Europe, which can no longer count on abundant energy supplies from the USSR. The Europeans will seek solutions in energy conservation, in the replacement of oil by gas (including liquid gas), in the revitalization of the old deposits and in all-European energy cooperation under the "Lubber's plan". In this area, EEC-USSR collaboration is in sight. In the light of the recent developments in the Persian Gulf, Europeans will be more selective in choosing suppliers and will try to diversify their sources of supply widely. However, the total energy demand will grow. Hence, there will be opportunities for oil and gas-exporting countries, in particular in Africa and Latin America, if the latter manage to stay politically stable.

14. Minerals. The growth in demand may be only moderate. With the iron industry in structural decline, Europe will be more self-sufficient in iron ore and scrap. One may expect a stable demand for non-ferrous metals and a growing demand for aluminium, due to lack of local competitive bauxite deposits. For ecological reasons, asbestos will disappear from the market. The future of raw materials for nuclear energy is also questionable, until a new safe nuclear power technology is developed.

15. Food, agricultural and raw materials. Extending over new agricultural territories, CEES will make Europe more self-sufficient in food. Although the EEC "common agricultural policy" will not be replicated throughout CEES, it certainly will be an impediment for outsiders. Non-food agricultural products may have a better future. Among tropical foods, the fruits from far-away developing countries may be in danger if CEES somehow engulfs the Mediterranean area. This is equally true for wines and non-seasonable vegetables.

16. Chemicals. One may expect within CEES a growing specialization, particularly in small-tonnage chemistry and pharmaceuticals. More effective utilization may reduce demand for fertilizers and pesticides.

17. Machinery and technologies. Because of specialization and modernization rather than new construction, this sector will be dominated more and more by industrial cooperation and subcontracting. Ship-building and automobile production may be sensitive to overseas competition and lose a part of the European market. The developing countries may fare well in medium-technology machinery, electronics and material-intensive subcontracting.

18. Consumer products. Shortages in Eastern Europe and social unrest may force the governments concerned to undertake massive intra-European imports of these products, particularly in the framework of the support given by the West for the recent changes in Eastern Europe. However, in the long run, one may expect a large-scale shift in the supply of Eastern European consumer imports from the West to the South, as has already occurred in certain developed market economies. Western Europe's demand for these products from outside will be stable.

19. Services. With its technological superiority over the developing countries, CEES may continue to be interested rather in the traditional services from those countries, such as shipping and tourism. The labour force from the developing countries will face severe competition in Western Europe from an expected emigration from Eastern Europe of some 8 to 10 million people. Much will depend on the specific immigration priorities set by the countries admitting migrants. Moreover, one should not rule out the possibility that the above-mentioned outflow from East European countries will be compensated for by importing labour from the South.

20. The above assumptions and expectations - tentative as they are - are examined in greater detail in the next chapter.

## Chapter II

## THE IMPLICATIONS FOR TRADE

21. In the short run, trade between developing countries and Europe may grow only moderately. Western Europe may enter a new recession triggered by events in the Persian Gulf and recent development in the economy of the United States. In addition, firms from developing countries may wish to explore new opportunities and openings in the changing Eastern Europe. The profound changes in business structures in Eastern Europe may, however, take several years before they become trade-creative. Moreover, Eastern Europe is historically oriented towards western markets, both for exports and imports. The Soviet Union will continue to offer a large market for developing countries, but its parliament is currently reluctant to finance overseas technical assistance, which for many years was a pillar for exports from the Soviet Union, and the enterprises entitled to operate abroad prefer free-currency proceeds.

22. However, in the long run, the situation may change in favour of developing countries. Eastern Europe cannot replace developing countries as suppliers of basic commodities for the West European market, nor can it compete with their low-price consumer goods. The enlarged European market will create greater demand for developing countries' exports; and the CEES external economic border cannot be so rigid as that of EEC.

23. Therefore, one may expect a slow growth in European trade with developing countries until the mid-1990s, and these countries' share of the market may even decline. However, thereafter, and closer to the turn of the century, this trade may accelerate and the share of the developing countries be regained or even become slightly higher than it is now.

24. Taking into account the structure of mutual trade, developing countries have not much to lose by "EEC-1992". The same is partly true in the case of the EEC-EFTA economic merger, since these blocs are trading predominantly in manufactures and thus only a few developing countries exporters of manufacturers may be effected. The entry of N+N into CEES would have hardly any impact on developing countries. The Mediterranean North lip (Malta, Cyprus, Yugoslavia) may affect developing countries' exports of tropical fruit, seasonal vegetables, textiles, wines and non-ferrous metals. However, these countries already have access to EEC and EFTA markets. Experts from other N+N (Sweden, Finland, Switzerland and Austria) would not affect developing countries' interests.

25. Nor do the countries in Eastern Europe pose a particular threat to the developing countries. Except for some agricultural products, the East European countries import similar products from developing countries as does Western Europe (see annex 3). With regard to consumer products, these countries are not competitive with the South either. It is also very unlikely that they will engage in such consumer sectors in the future, particularly in view of the similar unsuccessful experience of Poland and Hungary in the 1970s.

26. As a partner - rather than a competitor - for developing countries, Eastern Europe is a very special case. Most of these countries, except the former German Democratic Republic and Romania, were historically western-oriented and the share of the developing countries in their trade has been very modest. In the short run, owing to the economic crisis, their aggregated demand for exports from developing countries may decline. Among 35 products having considerable "developing country contents", the Eastern European production of 20 was lower in 1989 than in 1988 and of 31 lower in 1990 than in 1989. 6/ Since their trade with developing countries has been mainly in convertible currency, the East European countries are drastically economizing their assets with a view to meeting their debt service. The only exception may be energy, because of the drying up of the cheap supply from the USSR. Finally, EEC and EFTA seem to have priority rights for all East European resources and innovations.

27. In the long run, the prospects for developing countries in Eastern Europe seem to be brighter. This area is, after all, no stranger to international trade. In 1988 (1980=100) the foreign-trade turnover of Hungary was 179 in comparison with GNP growth 116, Bulgaria - 165 and 139, Czechoslovakia - 162 and 117, the German Democratic Republic - 148 and 108, Poland - 132 and 111 and Romania - 99 and 131 respectively. 7/ There are good reasons to believe that after the period of adjustment and modernization, these countries will resume their demand for a wider range of developing countries exports (due to narrowed specialization in production) and they may be more competitive in selected export areas. The commodity structure of trade of Eastern Europe with developing countries is stable (see annex 3) and therefore the economic complementarity between them may continue. In addition, the East European raw materials market, no longer a captive market of the USSR, will be open for partial resharing among developing countries.

28. Equally important, their trade which was previously "sheltered" by the CMEA protocols will be liberalized and domestic markets will be open for foreign competition. Finally, taking into account that their industrial structures are not over-concentrated (the share of small and medium-size enterprises in their total number is still in Hungary - 78 per cent, Poland - 75 per cent, Bulgaria - 74 per cent, Romania - 22 per cent, Czechoslovakia - 10 per cent), developing countries, penetrating this area have a real chance to establish themselves.

29. The largest market for developing countries in Eastern Europe has always been the Soviet Union. With a much higher share of developing countries in its trade and its greater stability, the country is transforming itself into a more open business society through market reform now under way. This reform explicitly calls for a liberal economy, progressing in competitive interdependence with the global one. Even before the reform, the Soviet foreign trade turnover grew faster than GNP. Despite the economic slow-down, the Soviet trade with developing countries increased in 1989 by 12 per cent over 1988. Finally, the Soviet Union still is a major donor country and provides large-scale official development assistance to the South. It trades with all areas and, in entering CEES, it would not sacrifice other markets and commitments.

30. The USSR might play a dual role in the CEES process, namely as a member of Europe on the one hand and as a bridge between the European and Pacific integrations on the other. This approach is already embodied in the "Lubbers' plan" (energy) and in projects for trans-Siberian transport and communication development, submitted by the USSR to EEC and IMF for support. In the area of trade, this means that the country, far from confining its market to Europe, is on the contrary global-oriented. In particular, the USSR might be in favour of a comprehensive economic agreement with ASEAN, similar to the USSR-EEC agreement, and similar arrangements with other regional and subregional integration groups of developing countries.

31. The recent economic slow-down and the structural adjustments envisaged in the USSR do not allow for any sharp rise in trade with developing countries during the period of transition to a market-economy system. Their share, apparently, will stay the same until 1993. However, thereafter the business opportunities of these countries will multiply, although not automatically.

32. The reform under review envisages:

- large-scale privatization of State property and demonopolization of the Soviet industrial structure, conducive, inter alia, to the renaissance of small and medium-size businesses;

- allowing all interested Soviet enterprises to operate internationally; opening the Soviet market for foreign competition; multibanking system for currency operations;

- introducing new trade-regulating mechanisms, shaped in accordance with international rules and principles; full membership for the USSR in GATT, and eventually in IMF and the World Bank.

33. Commercially, this means a massive redistribution of the control over the domestic market between the local and foreign enterprises, and more chances to exploit it for those who are competitive. In this process the businesses in CEES may, indeed, play a stronger role. However, the "marketization" may equally provide the developing countries with additional access to the Soviet end-users - and not necessarily in form of sporadic "niches" only. Structurally, the reform would bring about an industrialization of Soviet exports and hence a declining share of commodities that competed with those of developing countries. Moreover, the USSR is going to preserve its non-renewable resources, procuring them by import. The challenge to all exporters is to step up and diversify their supply of the Soviet consumer market.

34. All in all, new business mechanisms and the revitalization of the economy will, in the long run, make the Soviet market more open, attractive and adaptable for developing countries than ever. The main vehicle for cooperation to this end will be contracts between foreign private enterprises and the Soviet newly emerging non-state-owned businesses, which may make mutual trade self-sustained and more balanced.

## Chapter III

## THE IMPLICATIONS FOR INVESTMENT, DEBT AND OFFICIAL DEVELOPMENT ASSISTANCE

35. Promotion of trade with developing countries which at the same time could facilitate their economic development nowadays needs to be supported by investment and financing. New financing is also essential to facilitate their debt servicing. For decades Western Europe has played a major role as investor and donor. The relevant characteristics of CEES, however, look more complex.

36. Even Western Europe, owing to the budget constraints in major countries, is no longer an abundant source of official development asistance. The present level of ODA is well below the 0.7 per cent GNP target. Since there are pressing domestic demands for budget support for the structural adjustments needed for "EC-1992" and EEC-EFTA market integration, ODA to the South in the short run may do no more than remain stable. West European private lending institutions are over-exposed and concerned primarily to recover their funds, or at least the interest payments.

37. In Eastern Europe only the USSR was traditionally a large donor for the South. However, with a high share of "bad loans" in its portfolio and large-scale debt service overdue in developing countries, the Soviet parliament is determined to reduce ODA to a bare minimum. The non-convertible rouble credits of the USSR to the developing countries were used as a vehicle for supply of the products needed in the USSR, as imports of these products were used for repayments of credits. Nevertheless, a tight money policy has been proclaimed, both domestically and in international operations. Finally, the country has a rather high rate of debt servicing of its own, particularly in 1991-1992. Other Eastern European countries have now almost disappeared as donors and, on the contrary, are heavy debtors, seeking regular reschedulings.

38. The CEES is not to be seen simply as the sum of its two parts, but also as their interaction. There are large intra-European financial flows (both ODA and private) influencing the international money market. Observers usually refer to the flows as flowing from West to East, but the real situation is more complex. Even with intergovernmental loans, PHARE, etc., the outflow of funds from Eastern Europe to the West now exceeds inflows, which may increase the Western potential for financial transfers to developing countries. For example, at present the new borrowings of the USSR are almost half of repayments it makes. On the other hand, private investment still flows primarily to the East without a significant profit remittance. With investment legislation being enacted in the mid-1980s only, many investors had no time to become operational: besides many of them prefer to reinvest their honeymoon profits into these newly penetrated markets. For example, out of 2,400 joint ventures in the USSR as at October 1990, only 500 have already been in operation, only 200 have shown profits in their balance-sheets and only a few have remitted these profits abroad.

39. In the medium term the role of ODA and intergovernmental loans in the development of Eastern Europe, except for emergency situations, will decline.

In contrast, private investment is becoming the major channel of capital injection in the East European economies and this is now proclaimed government policy in the majority of those countries.

40. Official development assistance from Europe to developing countries is likely to be stable in the short run, with an upward trend in the late 1990s. Private financing of Eastern Europe would be in the form of foreign direct investment. As a result of the creation of CEES and the opening up of opportunities in Eastern Europe and the USSR, Europe may attract some private investments from outside. This process may have a negative effect on developing countries.

41. As for Eastern Europe and the USSR, they may in the long run reappear as donors. Seeking reliable sources of supply, the East European countries will be forced to expand credits and investment to developing countries for production on the spot. A promising avenue in the Soviet case is to swap some of the $US 100 billion of its debt assets in developing countries into investment for the production of commodities and consumer products which it needs, with subsequent export to the USSR.

42. Reverse financial flows from developing countries to Eastern Europe are insignificant because of the limited ODA previously rendered and the small East European markets which are less attractive for investment. The debt obligations of developing countries towards the USSR are much bigger, and the vast Soviet market is attractive for their capital. As at October 1990 about 15 per cent of joint ventures in the USSR were set up with partners from developing countries.

## Chapter IV

## TRADE POLICY AND INSTITUTIONAL ISSUES

43. Institutionally, CEES would mean an accelerating integration of Eastern Europe and the USSR into the international trading system, but this integration too may have its own intra-European and global follow-up.

44. It is reasonable to expect a strengthening and multiplying of the all-European institutions serving as an infrastructure for CEES. The intergovernmental bodies will be supplemented by non-governmental organizations. The most influential within this network will certainly be the European Bank for Reconstruction and Development, the Commission of the European Communities, the European Council, Europarliament and United Nations Economic Commission for Europe. The future of the CMEA in this scenario is hard to predict, partly because of the weakening of its very foundation - i.e. the member countries' entitlements for a guaranteed supply of energy and raw materials from the USSR. Therefore, despite the nominal survival of CMEA the West in the short run is expected to deal with East European countries on an individual basis. In the long run these countries may have second thoughts about the CMEA, having understood that their bargaining position vis-à-vis the West and EEC will be stronger if they act collectively rather than individually. However, in the present political mood they need time and experience for such a shift in trade policy to become possible.

45. The above analysis leads to the following conclusions:

- Step by step, Europe will speak in global affairs from a common position and sometimes with a collective voice. The common all-European position will be elaborated either in the framework of the European institutions or on an ad hoc basis; the CMEA member countries will try to join de jure or de facto either the Group of 77 (Mongolia, Bulgaria) or Group B (the rest of Eastern Europe). In these circumstances the Soviet Union may prefer to participate in the United Nations individually, with a status closely resembling that of China. CEES may generate some centrifugal forces within Group B towards more autonomy for a new Europe. Nevertheless, it seems likely that Group B will stay intact.

- The final result will be a more definite diplomatic bifurcation in the United Nations, with less room for group combinations both in the lobby and in the official chambers.

46. In practical terms, one may expect some alterations in the developed countries' trade policy towards developing countries. With Eastern Europe engulfed in CEES this policy may be:

- based on more similar and internationally acknowledged trade policy instruments, since such instruments in Eastern Europe would be brought into line with GATT and IMF rules:

- more multilateral than bilateral, since Eastern Europe will join the major international organizations;

- less enforced by administrative regulations and increasingly based on law, including the common international law, because of the dismantling of the administrative command system in the foreign-trade management in Eastern Europe;

- a policy with more say for the business community.

47. At the same time, the effect on the internationl market will be regulated not only by procedures on the CEES external borders. Because of the differences in the level of development and business mechanisms of the participating States, there will be many internal economic and other borders within CEES, which at most may be no more than a free-trade area for a long time to come. Not all these borders (barriers) are subject to current multilateral trade and investment agreements, and the outsiders and the international institutions concerned will have a busy time dealing with these trade policy collisions.

48. The first such multilateral agreement to feel the strain may be the generalized system of preferences (GSP) for the developing countries. The GSP has already deteriorated through the enlargement of EEC and its impact is diminishing with every new round of multilateral trade negotiations in GATT. In addition, the ACP arrangements and some bilateral associations with EEC have the effect of dividing the South. The official EEC and EFTA statements concerning the GSP are now fairly general, and it looks as if this system is of a secondary importance for Eastern Europe too. Some of these countries (Romania, Bulgaria) claim GSP status for themselves, and Albania, returning to the international community, may also be entitled to join this club.

49. Various political statements throughout Europe suggest that the principle of preferential treatment for developing countries will remain valid within CEES but that it may be seriously affected. Specifically, a single GSP scheme, for CEES as a whole is hardly feasible, because the trade policies of its participants will not be integrated that closely for a long time. Therefore, there will be individual GSP schemes for various countries and groups within CEES. The biggest one may emerge in the EEC-EFTA merger, if the regime for GSP products is regulated in common. The GSP schemes of Eastern Europe may undergo changes because of the modernization of customs tariffs or entering into association with EEC, which may result in smaller preferential margins.

50. The substance of the EEC-Eastern Europe association treaties is not yet clear. It looks as if the Communities would not be ready to enhance tariff preferences, but rather to reduce non-tariff barriers and include some regulations beyond traditional trade and aimed at investment and intellectual property in particular. Consequently, there is no reason to speak of a "second Lomé network" to the east of EEC. However, the association models will certainly be extended over the countries than the Lomé States, which means that some negative effects for developing countries in particular sectors cannot be ruled out.

51. With this in mind, some countries - developing, Mediterranean or other in special agreements with EEC - may wish to request consultations with EEC on the consequences for them of both the EEC-EFTA merger and the other associations under review. There are legal instruments for this in GATT rules and in the texts of the EEC agreements with the countries concerned. Geneva or Brussels may offer suitable sites for such consultations, but any such endeavours would not be practical before the conclusion of the Uruguay Round.

52. The legitimate forum for the GSP talks is UNCTAD. Therefore, in the preparations for UNCTAD VIII the member States may wish to place this issue on the draft agenda and to do some preparatory work with a view to assessing the magnitude of the problem and to suggesting appropriate solutions. A brain-storming task force of internationally renowned specialists in the matter may also prove useful for this purpose at an advanced stage.

53. Whatever solutions for CEES-GSP interaction might be under discussion, it is almost certain that the future European GSP schemes will be "graduated" in accordance with the level of development of the developing countries concerned, and not across-the-board schemes as previously. The schemes are also likely to have some built-in limitations such as tariff quotas, conventional arrangements, and safeguards.

54. In a global context, the reaction of the United States and Japan will affect the very realization of CEES. Both countries have good reasons to heed developments in Europe that strengthen its competitive and bargaining position vis-à-vis them. Unable to intervene in this process directly without upsetting the alliance, they will probably prefer to monitor CEES, trying to deal with its negative effects either by invoking existing legal instruments or by seeking individual arrangements.

55. Early warning of this kind of approach is to be found in the United States challenge to the "common agricultural policy" of EEC in the framework of the Uruguay Round. Equally, the United States has made a special appeal to GATT on the subject of EEC-Eastern Europe temporary arrangements for the market regime of the former German Democratic Republic. To be sure, any EEC-EFTA joint moves will be subject to United States questioning in the GATT too. In other words, considering CEES to be inevitable, the United States will at least seek some form of compensation. At the same time, the United States is pursuing an official bilateral understanding with EEC (or with a broader group of countries). Since they are all contracting parties to GATT, the partners rivals have limited room for commercial give and takes. Public statements hint at the possibility of a sort of new Atlantic Charter, political in nature, setting new trade rules between the old and new continents and containing some practical solutions for the most sensitive sectors and issues.

56. The United States companies are far behind competitors in tapping Eastern European markets and apparently prefer to await the outcome of the reforms under way. Glad though it is to see Eastern Europe back in the market-economies club, the United States do not exercise active economic patronage over this area. Equally, in looking ahead to CEES, American

businesses invest much more massively in EEC and EFTA than in the remainder of Europe. The exception is the USSR, where, with only marginal non-grain trade, the United States is the second most important partner of joint ventures operating on Soviet territory.

57. Because of its sophisticated export specialization and its competitive edge, Japan has managed to increase its exports to EEC and EFTA gradually, despite all their counter measures. The same is true for its exports to Eastern Europe and the Soviet Union, despite the duty-free trade within CMEA. Led by its "sogoshosha", Japan has increased in 1988 its trade with the USSR by 20 per cent compared to 1987 and by 23 per cent with the European CMEA countries. Japanese business and government are also monitoring the creation of CEES, but at this stage they do not appear to be seeking any individual agreements with its parts, trusting rather in the effect of the large investments they have already made within CEES perimeter.

## Chapter V

## THE SOVIET UNION IN A COMMON EUROPEAN SETTING

58. The new political thinking in the Soviet Union has a distinct European content. Apart from the political aspect, Europe is a laboratory for the Soviet Union's entry into the international trading system; it is the USSR's most important trade partner, creditor and the source of management skill. Accordingly, the USSR cannot be indifferent to the future of any part of this continent, including Eastern Europe.

59. With its new-found faith in the virtues of an open market economy, the USSR takes a broad-minded and flexible approach to CEES technicalities. In its relations with EEC and EFTA the USSR is ready to expand and deepen the existing legal arrangements to the utmost, and even to envisage a sort of mutual free trade zone. The USSR is also well disposed to economic initiatives in the Mediterranean basin.

60. Nevertheless, as a bi-continental country, the USSR has no wish to be divided or to lose its own identity within CEES. Similarly, the USSR seeks a proper balance of interest between a new Europe and the developing countries. In the Strategy of Foreign Economic Relations till the year 2000, adopted in October 1988, the Government committed itself to keeping the share of developing countries in Soviet foreign trade at the same level as before and to viewing the country not only as a "citizen of Europe", but also as a "citizen of the World".

61. The specific commitments of the USSR within CEES may be complex and, depending on the attitude of partners and the balance of interests concerned, may cover the following:

- a freer access to Soviet natural resources in all forms recognized by international practice, including entities under 100 per cent foreign ownership and control, and a long-term lease of these resources to free economic (development) zones;

- a broad liberalization of the import regime, including NTBs, provided that the Soviet exports to the remainder of Europe will not be in an inferior position;

- a set of selected measures towards an early convertibility of the rouble, with an advanced extension on profit remittance and investment guarantees;

- participation in all-European policies on agriculture, transportation, technology, and environment;

- sharing the European commitments to global development and specific actions to facilitate trade, financing and debt settlement between CEES and developing countries.

In any case, the Soviet specialists do not regard CEES as an inward-looking "sheltered" area.

62. Nor does the USSR consider Western Europe to be its permanent donor. Even now, in a critical economic situation, the USSR is seeking from the remainder of Europe no more than some emergency support (food and pharmaceuticals for the 1990/91 winter), untied financial credits to restore its balance of payments, and above all technical assistance for nurturing and strengthening the mechanisms and institutions of the new-born Soviet market economy. After a period of transition to a market economy, this sector will be dominated by the normal commercial relations, with due servicing of the previous credits.

63. More explicitly, the USSR is going to balance its European interests with those of developing countries, inter alia, through:

- maintaining the preferential treatment for imports from developing countries. The provisions guaranteeing this are already embodied in the new USSR customs legislation. Technically, these provisions permit an extension of these preferences beyond the list of manufactures, and a flexible approach to individual countries and forms of preferences. For example, preferences may be also given for products imported as payment credits granted by the USSR. The whole scheme will be made public after approval by the Supreme Soviet.

- following a flexible debt-service policy towards developing countries. Their debts to the USSR may be paid in kind, including with new industrial products, by debt-to-investment swaps or by the operations on the secondary market. The USSR may choose to consider special measures to alleviate the debt burden concerned in the global and CEES framework or individually. The Soviet ODA statistics will be brought into line with international standards;

- providing developing countries with the opportunities to enter the Soviet market in all types of business transaction, including investment (with a national treatment eventually), facilitating contacts with private businesses of the South;

- allocating funds for official development assistance, managed either by the Supreme Soviet or by the new Soviet banking system; 8/

- providing developing countries with a free choice of Soviet bankers in trade and financial relations with the USSR and maintaining the modes of payments appropriate to both sides;

- keeping under State management the Soviet structures in charge of the capital construction in developing countries on the credit terms;

- developing modalities for business arrangements between developing countries and the individual Republics and regions of the USSR;

- adhering to the United Nations resolutions and decisions, including those of UNCTAD, as well as to the international commodity agreements to which the USSR is a party.

## Chapter VI

## CONCLUSIONS

64. Although the specific shape and mechanisms of CEES are still being worked out, the USSR is ready to engage in advanced consultations with developing countries on the implications of CEES for mutual trade. The same procedure might be recommended to other European countries or to CEES regulatory bodies, if any.

65. As a means of providing information and building confidence, CEES periodic reports might be presented to appropriate international bodies, like UNCTAD. The Lomé Convention and other preferential treaties involving EEC and EFTA could be reviewed with a view to their extension (possibly step-by-step) to other parts of CEES or to its territory as a whole.

66. The list of CEES-related preventive, compensatory or adjustment measures suggested above is in no way exhaustive. This study is rather an invitation to the international community and its authoritative institutions, including UNCTAD, to pay attention to this matter, to match the practical steps towards CEES with in-depth analysis of their consequences for the developing world and to come up with recommendations that would balance the European and the global development interests concerned.

67. To sum up, although CEES holds concerns and uncertainties for developing countries in the short run, at a later stage it could well become an additional vehicle for their economic and social growth.

## Notes

1/ UNCTAD, Trade and Development Report, 1989.

2/ CMEA, Matters of Promoting CMEA-EEC Economic Co-operation. The statement by K. Haenisch, Vice-Chairman of the Socialist Group of the European Parliament, (Moscow, 1990), p. 29.

3/ UNCTAD, Trade and Development Report 1990, p. VI.

4/ Vienna document, p. 20.

5/ Doc. CSCE/KWZEB, 15/Rev. 1, p. 3.

6/ These 20 products are iron, steel, rolling steel, pipes, oil products, lubricants, ammonia, sulphuric acid, caustic soda, fertilizers, plastics, synthetic rubber, cotton fabrics, leather, leather goods, phenol, cigarettes, resins, etc. The additional 11 products with declining production in 1990 are mazout, calcium soda, plastics, synthetic fibres, chemical fibres, caprolactam, tyres, wool fabrics, tricot, underwear and shoes.

The products with large "developing country contents" still rising in production in 1990 are detergents, socks, natural oils and margarine.

Source: Statistical Bulletin of the CMEA, 1989 (Moscow, 1990), pp. 8-35, and the CMEA Statistical Office .

7/ The National Economies of the Countries Members of the CMEA, 1988 (Moscow, 1990) p. 14 and 65.

8/ The system, to a large extent a replica of the United States Federal Reserve, consists of the Central and 15 Republican Banks and is the instrument of their joint management of the Soviet currency and monetary policies.

Annex 1

CEES as an Economic Power, 1989

| | Western Europe | | | Eastern Europe | | Total |
|---|---|---|---|---|---|---|
| | EEC | EFTA | Others | Except USSR | USSR | |
| Population millions | 325.9 | 31.9 | 23.7 | 112.4 | 283.1 | 770.0 |
| GNP ($ billion) | 4 829.8 | 1 517.0 | ... | 1 237.1 | 3 389.6 | (10 973.5) |
| Export ($ billion) | 790.5 | 132.9 | 1.5 | 95.2 | 97.3 | 1 117.4 |
| R & D spending ($ billion) | 65.3 | 11.3 | 1.5 | 14.4 | 48.3 | 140.8 |
| Merchant fleet (millions) (d.w. tons) | 59.4 | 17.8 | 10.1 | 10.6 | 25.8 | 123.7 |

Source: Soviet State Foreign Economic Commission Statistical Service.

East European contribution to the CEES

The East European countries and the USSR may contribute to CEES, when it eventually comes into being, the following resources, facilities and assets:

1. Basic resources of oil, gas, coal, ores and other minerals, equal approximately to 30 per cent of the world total; electric power station capacity of about 454 bill Kwt; 137 millions strong labour force.

2. Agricultural area of 245 million hectares, and livestock of 142 million head.

3. An output of 2.2 trillion Kwt/n of electric energy, 635 million tons of oil, 750 million tons of coal, 800 billion $m^3$ of gas, 250 million tons of iron ore, 225 million tons of steel, 1.7 million tons of bauxites, 4.8 million tons of fertilizers, 9.3 million tons of plastics, 356 million $m^3$ of timber.

4. In technologically advanced sectors - 300 million microchips, 400 million semi-conductors, 125 million optical fibre elements.

5. As human and technological basin, Eastern Europe and the USSR have 18.7 million specialists graduated from high school and 27.2 million from the special technical colleges, as well as 310 scientists and engineers per 10,000 of the population (developed market economies - 293 average). Thirty-two of the scientists and engineers are directly engaged in R & D, (developed market economy 20).

Source: Narodnoe Khosiastvo Stran - Tchlenov SEV, 1988.

Annex 2

Developing countries: comparisons with other areas of the international economy, 1988

| | (Areas, each = 100) | | | | Shares in world | |
|---|---|---|---|---|---|---|
| | Population | GNP | Exports | Imports | Exports | Imports |
| The United States | 1 090 | 54 | 180 | 126 | 11.3 | 15.6 |
| Western Europe | 745 | 49 | 46 | 45 | 43.6 | 42.9 |
| European Communities | 820 | 57 | 55 | 54 | 37.1 | 36.4 |
| EFTA | 8 246 | 388 | 325 | 312 | 6.3 | 6.3 |
| Japan | 2 163 | 102 | 219 | 310 | 9.3 | 6.4 |
| Countries in Eastern Europe | 659 | ... | 260 | 260 | 7.9 | 7.6 |

Source: Soviet State Foreign Economic Commission Statistical Service.

Annex 3

Structural breakdown of the trade between Europe* and developing countries
Share (in per cent)

| Commodity Groups | Developing countries exports to: EC | | | EFTA | | | Countries in Eastern Europe | | |
|---|---|---|---|---|---|---|---|---|---|
| | 1970 | 1980 | 1987 | 1970 | 1980 | 1987 | 1970 | 1980 | 1987 |
| All products | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| All food items | 23.3 | 12.0 | 18.1 | 8.1 | 10.0 | 15.6 | 42.1 | 51.4 | 37.2 |
| Agricultural raw materials | 8.6 | 3.2 | 4.4 | 9.6 | 3.0 | 2.7 | 20.6 | 8.7 | 7.1 |
| Ores and metals | 15.7 | 5.8 | 5.5 | 13.5 | 4.8 | 4.6 | 9.5 | 6.9 | 5.7 |
| Fuels | 36.8 | 64.9 | 29.8 | 26.5 | 64.3 | 18.7 | 2.4 | 22.3 | 15.4 |
| Manufactured goods | 10.4 | 13.2 | 41.4 | 22.1 | 16.6 | 57.7 | 25.0 | 10.3 | 34.2 |

Share of various segments of Europe* in developing countries exports by major commodity group
(percentage)

| Commodity Groups | Shares in the total developing countries exports of: EC | | | EFTA | | | Countries in Eastern Europe | | |
|---|---|---|---|---|---|---|---|---|---|
| | 1970 | 1980 | 1987 | 1970 | 1980 | 1987 | 1970 | 1980 | 1987 |
| All food items | 36.7 | 28.9 | 29.9 | 3.4 | 2.4 | 2.4 | 9.5 | 13.3 | 10.7 |
| Agricultural raw materials | 29.6 | 24.2 | 26.3 | 3.1 | 2.2 | 1.5 | 12.5 | 7.1 | 7.4 |
| Ores and metals | 42.5 | 36.6 | 29.6 | 3.4 | 3.0 | 2.3 | 4.5 | 4.8 | 5.4 |
| Fuels | 38.7 | 28.3 | 24.1 | 2.6 | 2.8 | 1.4 | 0.4 | 1.0 | 2.2 |
| Manufactured goods | 19.1 | 20.3 | 18.8 | 3.8 | 2.5 | 2.4 | 8.0 | 1.7 | 2.7 |

Source: UNCTAD, Handbook of International Trade and Development Statistics, 1989, p. 72-75.

* Europe including EC, EFTA and countries in Eastern Europe.